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# Incentives for Hiring Welfare-to-Work Participants

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# The Community Tax Law Report™

An interdisciplinary approach to the taxation  
of low-income individuals.

Vol. 6 No. 1

Spring/Summer 2002

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## Focus on Welfare-to-Work Tax Credits

### INCENTIVES FOR HIRING WELFARE-TO-WORK PARTICIPANTS

by **Mary L. Heen**

#### Introduction

The Job Creation and Worker Assistance Act of 2002,<sup>1</sup> signed into law by President Bush on March 9th, extends the Work Opportunity Tax Credit (WOTC)<sup>2</sup> and the Welfare-to-Work Tax Credit (WtW)<sup>3</sup> for two more years. The credits provide employers with tax incentives to hire former long-term welfare recipients and certain other economically disadvantaged workers, a goal that comports with the welfare-to-work focus of welfare reform legislation adopted by Congress in 1996.<sup>4</sup> This article describes these employer tax credits, explains how they have evolved from prior versions of similar targeted tax credits, and considers their operation as tax-delivered subsidies.

The WOTC, enacted in 1996,<sup>5</sup> targets eight categories of difficult-to-place workers, including families eligible to receive welfare benefits, ex-felons, vocational rehabilitation referrals, food stamp recipients, qualified veterans, SSI recipients, and high risk or summer youths living in an empowerment zone, enterprise community or a renewal community.<sup>6</sup>

The WtW tax credit, enacted in 1997,<sup>7</sup> more narrowly targets workers who have received welfare benefits during the previous two-year period.<sup>8</sup> Employers receive a tax credit for hiring former welfare recipients who have left welfare for work under time limits established by welfare reform legislation.

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## WtW Tax Credits: *continued from page 1*

Jobs Tax Credit and the former credit for welfare-related Work Incentive (WIN) Program expenses, have periodically expired and been extended by Congress, sometimes retroactively. They most recently expired on December 31, 2001. The extension under the legislation enacted last March is effective retroactively for individuals who begin work for employers after December 31, 2001 and before January 1, 2004. Legislation (H.R. 4626), passed by the House in May, is currently pending in the Senate to combine the two credits into one modified credit for workers from nine targeted categories (the current eight WOTC categories, slightly more broadly defined, plus a ninth category containing a modified version of the current WtW tax credit).

### Some History

Although modified somewhat from the design of their sharply criticized predecessors, the WOTC and WtW Tax Credit share essential similarities with the prior tax credits. They provide time-limited employer wage subsidies for certain low-wage or difficult-to-place workers.<sup>9</sup>

As noted above, the WOTC replaced the Targeted Jobs Tax Credit, which was enacted in 1978, and periodically lapsed and renewed until it was finally allowed to expire in 1994.<sup>10</sup> The Targeted Jobs Tax Credit (TJTC) replaced the New Jobs Credit, which was enacted in 1977, and allowed to expire in 1978.<sup>11</sup> The WtW Tax Credit descends from a former tax credit, terminated in the early eighties, for wages paid welfare recipients under the WIN program. Congress established WIN in 1967<sup>12</sup> and modified it during the early seventies to place certain welfare recipients in jobs.<sup>13</sup> For the ten-year period from 1972 through 1981, the WIN-welfare recipient tax credit allowed an employer a tax credit for wages paid to eligible employees up to specified percentages of their compensation during the first two years of employment.<sup>14</sup> After 1981, Congress included the WIN tax credit in modified form as part of the TJTC. Thus, in their various permutations, these kinds of employment tax credits have been in existence for thirty years.

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## The Current Credits

The Clinton administration pushed for the WOTC and the WtW tax credit as a way of buttressing efforts to move welfare recipients into jobs. They fit within the President's (and Congressional) political priorities in "ending welfare" under the welfare legislation signed in 1996. In justifying its proposals, the administration's analysis directly addressed and responded to some of the criticism of past programs. Two of the major criticisms of the TJTC, the predecessor of WOTC, were 1) that the credit resulted in windfall gains for employers because they were subsidized for doing what they would have done anyway in the absence of the program (employ low-wage, low-skilled workers in high-turnover labor-intensive businesses),<sup>15</sup> and 2) that it provided little or no improvement in the long-term job prospects of the covered workers.<sup>16</sup>

Some aspects of the WOTC and WtW tax credit were explicitly designed to mitigate those criticisms, including the reformulation of some target groups, the modification of the certification process, the lengthening of the minimum employment periods for maximum credit receipt, and the increase in the subsidy amount to offset expected employer reluctance to hire long-term welfare recipients.<sup>17</sup>

Congressional Committee reports explained the modifications adopted in WOTC, and noted the temporary nature of the credit as follows:

The bill creates a new program whose design will focus on individuals with poor workplace attachments, streamline administrative burdens, promote longer-term employment, and thereby reduce costs relative to the prior-law program. The Committee intends that this short-term program will provide the Congress and the Treasury and Labor Departments an opportunity to assess full the operation and effectiveness of the new credit as a hiring incentive.<sup>18</sup>

In signing the legislation establishing WOTC, President Clinton emphasized that the bill responded to concerns about the TJTC:

... the Act provides a significant incentive for employers to hire people from certain targeted groups most in need of jobs, such as high-risk youth. I am pleased to see improvements that address many of the concerns raised about implementation of the TJTC. For example, the

minimum employment period required before an employer becomes eligible for the credit will promote longer, more meaningful work experiences for those hired.<sup>19</sup>

In addition, administration officials suggested that combining targeted wage subsidies with a constellation of other job retention services such as child care and transportation would improve their effectiveness.<sup>20</sup> There is some academic support for this view. For example, a study of the TJTC concluded that it may

have "modestly improved the employment rates of economically disadvantaged youth," and that although "information/stigma problems" appear to limit the effectiveness of stand-alone targeted wage subsidies, wage subsidies for less skilled workers such as welfare recipients "are likely to be more effective when utilized in conjunction with labor market intermediaries that help provide some training, place-

ment services, and job retention assistance."<sup>21</sup>

Other criticisms of the TJTC were not addressed in the new proposals<sup>22</sup> by virtue of their design as targeted or selective hiring credits rather than as general job credits.<sup>23</sup> These included problems of low-income worker displacement (replacing ineligible workers with workers eligible for the credits) or discrimination against members of the targeted groups.<sup>24</sup>

### The Work Opportunity Tax Credit (WOTC)

The WOTC is intended "to provide an important incentive for employers to undertake the expense of providing jobs and training to economically disadvantaged individuals, many of whom are underskilled and/or undereducated."<sup>25</sup> It provides a credit of 40 percent of the first \$6,000 of qualified first year wages<sup>26</sup> to an employee who completes at least 400 hours of service for the employer, with a lesser percentage applicable for fewer hours of service.<sup>27</sup> The maximum credit for each targeted employee is \$2,400 (40 percent of \$6,000).<sup>28</sup> The WOTC is structured as part of the general business credit.<sup>29</sup> A number of credits are combined into the general business credit for the purpose of computing how much of each credit will be allowed in a given year and in carryback and carryover years.<sup>30</sup>

Each individual employee must be certified by the "designated local agency"<sup>31</sup> to be a member of one of the eligible targeted groups. The employer must receive the certification from the designated local

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*Continued on page 4*

agency by the time the employee begins work, or it must complete a "pre-screening notice" not later than the day the employee is offered employment. The "pre-screening notice," Form 8850, signed by both the employer and the employee, must be submitted to the

agency within 21 days after the employee begins work as part of a written request for certification from the agency.<sup>32</sup>

**The WtW tax credit is intended to "ease the transition from welfare to work for the targeted categories of individuals by increasing access to employment."**

Certain limitations on the availability of the credit restrict its nonbusiness use. The credit cannot be used for wages paid to an employee who is related to or a dependent of the employer or to an individual who is more than 50 percent owner of the business.<sup>33</sup> At least half of the employee's work must be in the employer's trade or business.<sup>34</sup>

If the employer previously employed the employee at any time prior to the hiring date, then the employee's wages may not be taken into account for purposes of computing the credit.<sup>35</sup> Other limitations respond to concerns about interactions with other federally-financed training and other subsidy programs,<sup>36</sup> with hiring replacements during labor disputes,<sup>37</sup> and with preventing circumvention by employers of the credit wage ceiling and other limitations on the availability of the credit.<sup>38</sup> No credit is generally allowed to tax-exempt organizations.<sup>39</sup>

#### **Welfare-to-Work Tax Credit (WtW)**

The WtW<sup>40</sup> tax credit is intended to "ease the transition from welfare to work for the targeted categories of individuals by increasing access to employment."<sup>41</sup> It provides a credit amount of 35 percent of the first \$10,000 of "qualified first-year wages" and 50 percent of the first \$10,000 of "qualified second-year wages."<sup>42</sup> Employers thus may be eligible for a maximum credit per qualified employee of \$8500 over a two-year period, beginning with the employee's first day of work.<sup>43</sup> Wages are "qualified" if paid to employees who are "long-term family assistance recipients."<sup>44</sup> Eligible wages include cash wages paid to an employee plus amounts paid by the employer for certain health plan coverage,<sup>45</sup> educational assistance,<sup>46</sup> and dependent care assistance<sup>47</sup> for the employee.

Each individual employee must be certified by the designated local agency<sup>48</sup> as coming within one of the three targeted categories of "long-term family assistance recipients," under rules similar to those that apply to

the WOTC.<sup>49</sup> The categories generally include members of families 1) receiving temporary assistance to needy families (TANF, the successor program to AFDC) for at least 18 consecutive months ending on the hiring date;<sup>50</sup> 2) receiving such assistance for a total of 18 months (whether or not consecutive) beginning after the credit's enactment date (August 5, 1997) if they are hired within 2 years after the date that the 18-month total is reached;<sup>51</sup> or 3) ceasing to be eligible for such assistance by reason of any time limits imposed by state or federal law, and having a hiring date not more than two years after the cut-off of assistance.<sup>52</sup>

The WtW tax credit is coordinated with the WOTC<sup>53</sup> and cross references numerous definitions and other limitations from the WOTC.<sup>54</sup> Each year, the employer may choose the credit that provides the greater tax benefit.<sup>55</sup> For example, if the WOTC is selected for a taxable year, the WtW tax credit may be chosen by the employer for the following taxable year if the covered period from the work beginning date for first-year or second-year wages has not yet been completed.<sup>56</sup>

#### **Tax-Delivered Employment Subsidies: Advantages and Disadvantages**

As part of its policy deliberations, Congress should assess the advantages and disadvantages of using the tax system as a delivery mechanism for employment subsidies compared to providing them through a program of direct grants. That type of assessment generally has not been a part of Congressional deliberations, however. Under current political conditions, Congressional budget rules have played a large role in the continued use of tax credits as expiring provisions.

A tax-delivered benefit does not permit the same degree of agency discretion or supervision, for example, as a direct grant program. In addition, it makes the income tax code more complex and difficult to administer.

On the other hand, the tax system may provide some advantages as a delivery mechanism for an employment subsidy, particularly if a large number of the employers are small to mid-sized businesses.<sup>57</sup> Businesses file income tax returns on an annual basis and smaller businesses generally may be more accustomed with the tax system than with special employment programs offered by the Department of Labor or

**B**usiness owners may be more likely to participate in a tax credit program that reduces their tax liability than in a "government subsidy" program to hire certain workers.

*Continued on page 8*

other government agencies. The administrative costs may thus be lower. In addition, business owners may be more likely to participate in a tax credit program that reduces their tax liability than in a "government subsidy" program to hire certain workers. These factors might justify using the tax system as a means of delivering the subsidy to employers rather than using a grant program to provide either workers or their employers with wage subsidies. In addition, past practice and familiarity may argue for not changing the delivery mechanism that has been used in the past.<sup>58</sup>

The predecessor programs of WOTC and WtW tax credit were criticized as being ineffective. Although some of the same criticisms apply to the WOTC and WtW tax credit programs given the similarity in design, it is still early to tell whether these programs will suffer from the same deficiencies. Preliminary information gives cause for concern. Historically, employment tax credits have suffered a track record of poor participation rates. Experience under the modified credits has been similar, with poor utilization rates by small and mid-sized employers.

#### **Utilization of Former Credits**

The New Jobs Tax Credit provided subsidies for an estimated 1.1 million employees in 1977, and 2.15 million in 1978.<sup>59</sup> The Targeted Jobs Tax Credit covered a peak of 622,000 workers in 1985 (approximately 0.4 percent of private employment) and then declined to 364,000 in 1992, with revenue losses of about \$500 million (in 1991 dollars) in the mid-eighties, declining to \$245 million in 1991.<sup>60</sup> Under the WIN tax credit program, which had low utilization rates, "no more than 20 percent of the WIN individuals known to have entered employment during the year were ever claimed by firms as tax credits."<sup>61</sup> According to a study done in the seventies, the WIN tax credit was paid on only 88,000 workers in fiscal 1973-75 out of 515,000 WIN enrollees who entered the labor market in that period. About \$9 million was credited against taxes in fiscal 1973, although part of the credit was for jobs that were later decertified because the employees were not retained for the required period of time.<sup>62</sup> In 1980, WIN tax credits were claimed for less than 10 percent of all new WIN registrants, and the annual revenue loss

attributable to the WIN credit was \$60 million in fiscal year 1981.<sup>63</sup>

#### **Utilization of Current Credits**

Available information on the WtW tax credit and the WOTC suggests that utilization rates under the most recent version of these employment tax credits may be similar. In fiscal year 2001, 438,604 WOTC certifications were issued and 97,072 WtW certifications, for a total of 535,676 certifications.<sup>64</sup>

In fiscal year 1999, state employment security agencies issued 335,707 WOTC certifications to employers and 104,998 WtW certifications; corporate employers claimed about \$138 million in WOTC credits on 1997 tax returns and individuals claimed \$15 million on 1997 returns.<sup>65</sup> The WOTC employers who earned most of the credits (66 percent) were large companies with gross receipts of \$1 billion or more, and were engaged in "nonfinancial services, such as hotel, motel, and other personal services, and retail trade."<sup>66</sup> In an analysis of state agency

data from California and Texas for 1997 through 1999, the U.S. General Accounting Office (GAO) found that about 3 percent of participating employers accounted for about 83 percent of all hires of WOTC-certified employees.<sup>67</sup>

Preliminary data from empowerment zones also show that utilization of empowerment zone employment tax credits tends to be highest among larger businesses, suggesting that the advantage of using the tax system to reach small and mid-sized businesses may be overstated. A GAO survey of the utilization of employment tax credits (including the empowerment zone employment credit, the work opportunity credit, and the welfare-to-work credit) and other tax incentives in nine empowerment zones found that large businesses (50 or more employees) had the greatest utilization rates.<sup>68</sup> The GAO surveyed 2400 business and received responses from 48 percent of the large urban businesses, 32 percent of the small urban businesses, and 46 percent of the rural businesses. Of those responding, the empowerment zone employment credit was used by 42 percent of large urban businesses, an estimated 6 percent of small urban businesses, and 32 percent of rural businesses. Among rural businesses, about two-thirds of the large businesses and about one-third of the small businesses reported using the credit. Large urban businesses and rural businesses reported claim-

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ing \$9.1 million for tax year 1997. Most empowerment zone businesses did not use the WOTC or the WtW tax credit (tax year 1997); however, those that did tended to be large businesses. Specifically, 11 percent of the large urban businesses and 14 percent of the large rural businesses used the WOTC as compared with an estimated 1 percent of the small urban businesses and 3 percent of the small rural businesses. By contrast, 3 percent of the large urban businesses, no small urban businesses, and 1 percent of the rural businesses used the WtW tax credit.<sup>69</sup>

A study of data on the use of the federal empowerment zone employment credit, based on 1996 tax returns, confirms those general trends. It reported a total of 1,254 taxpayers with such credits taken against regular tax liability comprised of 1,040 individuals (including sole proprietors, partners, S corporation shareholders, beneficiaries of estates and trusts, and cooperative patrons) and 214 taxable corporations.<sup>70</sup> In total, about \$15.11 million of credits were claimed, about \$9.59 million by individuals and \$5.52 million by taxable corporations. On the corporate side, larger businesses made up a smaller percentage of businesses claiming the credit, but accounted for a larger proportion of the credit claimed. About 72 percent of the credit was claimed by the 27 percent of taxpayers with assets over \$10 million.<sup>71</sup> Possible explanations identified for the low credit usage in empowerment zones included the general problem with using non-refundable tax credits to benefit businesses and individuals in economically distressed areas whose tax liability may already be small.<sup>72</sup>

Given the role of the employment security agencies in the certification process, the administrative costs generated by that participation,<sup>73</sup> and large businesses' greater past utilization of employment credits, these tax credit programs could be replaced by direct grant programs without loss of advantages provided by a tax-delivered program. However, past history with predecessor credits indicates that it would be unlikely for Congress to substitute appropriations for existing WOTC or WtW tax credits.

**The recent extension of the WOTC and WtW tax credit provides employers with two more years of tax incentives to hire certain difficult-to-place workers and former welfare recipients.**

## Conclusion

The recent extension of the WOTC and WtW tax credit provides employers with two more years of tax incentives to hire certain difficult-to-place workers and former welfare recipients. Preliminary information gives cause for concern about the credits' low utilization rates and raises questions about whether the credits make a long-term difference in the job prospects of economically disadvantaged workers. Those issues will receive greater scrutiny as studies assess the longer-term effects of the modified credits.

The first wave of welfare roll reductions generally involved easier-to-place workers and took place during a period of robust employment growth, even for low-skilled workers. It will be even more important—and more difficult—in the current economic climate to provide employers with effective incentives to hire workers targeted by the credits. ■

*Mary L. Heen is a Professor of Law at the University of Richmond. Copyright (c) 2002 by Mary L. Heen. Thanks to Harry Carawan, a recently graduated Richmond law student, for his assistance this past spring in updating the research for this article, and to the University of Richmond's Hunton and Williams Summer Research Fund for support during its preparation.*

1 Pub. L. No. 107-147, §§ 604, 605, 116 Stat. 21.

2 I.R.C. § 51.

3 I.R.C. § 51A.

4 Personal Responsibility and Work Opportunity Reconciliation Act of 1996, Pub. L. No. 104-193, § 103, 110 Stat. 2105, 2112-13, 2137 (repealing the individual entitlement to welfare and imposing a twenty-four month limit on welfare benefits without work and a sixty month lifetime cap on benefits).

5 The Work Opportunity Tax Credit, enacted by the Small Business Job Protection Act of 1996, replaced the targeted jobs tax credit. Pub. L. No. 104-188, § 1201, 110 Stat. 1755, 1768-72 (applying to individuals who begin work for the employer after September 30, 1996 and before October 1, 1997). The WOTC has been extended by Congress four times since then.

6 I.R.C. § 51(d)(defining eight targeted groups). A "high risk youth" is an 18-24 year old resident of an empowerment zone (EZ), enterprise community (EC), or renewal community (RC). Id. at § 51(d)(5). A "qualified summer youth employee" is a 16-17 year old EZ, EC, or RC resident who performs services for an employer between May 1 and September 15. Id. at § 51(d)(7).

7 The Welfare to Work Tax Credit was enacted by the Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 801(a), 111 Stat. 788, 869-71 (applying to individuals who begin work for the employer after December 31, 1997 and before May 1, 1999). The WtW tax credit has been extended by Congress three times since then.

8 The credits do not provide duplicate benefits. If an employer receives a WtW tax credit for an employee for a particular taxable year, no WOTC credit may be taken for the employee for that year. See I.R.C. § 51A(e).

9 This analysis focuses on the WOTC and the WtW tax credit, and

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draws from Mary L. Heen, *Reinventing Tax Expenditure Reform: Improving Program Oversight Under the Government Performance and Results Act*, 35 WAKE FOREST L. REV. 751, 798-817 (2000). Other employer tax credits provide targeted wage subsidies for more geographically restricted worker populations, including the Empowerment Zone Employment Credit, I.R.C. § 1396, the Indian employment credit, I.R.C. § 45A (currently scheduled to expire after December 31, 2004, see I.R.C. § 45A(f)), and the newly effective renewal community employment credit, I.R.C. § 1400H (treating certain "renewal communities" as if they were empowerment zones for purposes of a modified employment credit). See Joint Committee on Taxation, *Description of Present Law Regarding Tax Incentives for Renewal Communities and Other Economically Distressed Areas* (JCX-40-02), May 20, 2002; see generally BORIS I. BITTKER & LAWRENCE LOKKEN, *FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS*, ¶ 27.3.3, at 27-39 and 27-40 (3d ed. 1999) (describing employment credits). The Empowerment Zone Employment Credit provides a credit for portions of wages of employees who live and work in "empowerment zones," areas designated by the Secretary of Housing and Urban Development (urban areas) or the Secretary of Agriculture (rural areas) to have high levels of poverty, unemployment, and distress, and which meet certain other requirements. See I.R.C. §§ 1391, 1392; see generally, e.g., *EZ Gazette* (EZ project web site), <http://www.richmond.edu/~ezproj/> (for resources and links to other web sites).

10 Revenue Act of 1978, Pub. L. No. 95-600, § 321, § 554, 92 Stat. 2763, 2830, 2892 (enacting the targeted jobs tax credit and requiring the Secretaries of Labor and the Treasury to report to Congress by June 30, 1981, on its effectiveness in improving employment of the targeted groups). The TJTC was extended by Congress in 1981, 1982, 1984, 1986, 1988, 1989, 1990, and in 1991. In 1993, the targeted jobs tax credit was retroactively renewed after expiring again on June 30, 1992, and was extended through December 31, 1994.

11 Tax Reduction and Simplification Act of 1977, Pub. L. No. 95-30, 91 Stat. 126. See H.R. CONF. REP. NO. 95-263, at 291-92 (describing the new jobs credit, adopted in 1977, of 50 percent of the increase in each employer's unemployment insurance wage base above 102 percent of that wage base in the previous year, as limited by various caps, and an additional credit equal to 10 percent of the first \$4,200 of unemployment insurance wages paid to handicapped individuals, including handicapped veterans, who receive vocational rehabilitation).

12 Pub. L. No. 90-248, Title II, Part 1, § 204, 81 Stat. 884.

13 The WIN program was replaced by the JOBS program, enacted as part of the revision of the AFDC program by the Family Support Act of 1988 to assist parents in obtaining education, training, and employment needed to avoid long-term welfare dependence. See H.R. CONF. REP. NO. 100-998, at 1 (1988). The JOBS program was eliminated in 1996, along with the federal entitlement to welfare.

14 Former I.R.C. §§ 40, 50A, 50B.

15 Large employers in the restaurant, retail, hotel, nursing home, and chicken processing industries, as well as management assistance and consulting firms that helped those businesses with the necessary certifications and filings, were viewed as important lobbying forces in keeping the TJTC alive from 1978 to 1994. See, e.g., Elizabeth Garrett, *Harnessing Politics: The Dynamics of Offset Requirements in the Tax Legislative Process*, 65 U. CHI. L. REV. 501, 521-22 (1998). They have also been major sources of lobbying pressure in favor of the WOTC.

16 See, e.g., *Targeted Jobs Tax Credit: Hearing Before the Subcomm.*

*on Select Revenue Measures of the Comm. on Ways and Means*, 103d Cong. 76 (1994) (testimony of Robert B. Reich, Secretary, U.S. Dept. of Labor, stating that "the Administration has not sought an extension of TJTC in its present form" and summarizing the results of fourteen studies of the program over fifteen years); OFFICE OF INSPECTOR GENERAL, U.S. DEPT. OF LABOR, *TARGETED JOBS TAX CREDIT PROGRAM: EMPLOYMENT INDUCEMENT OR EMPLOYER WINDFALL?* 16-32 (Aug. 1994) (recommending after an audit of program year 1991 that the TJTC be discontinued after its expiration); see also U.S. DEPTS. OF LABOR AND TREASURY, *THE USE OF TAX SUBSIDIES FOR EMPLOYMENT* 4-7 (1986) (evaluating the New Jobs Tax Credit and the initial TJTC in effect from 1979-81) [hereinafter 1986 TREASURY EMPLOYMENT SUBSIDIES REPORT].

17 CONGRESSIONAL RESEARCH SERVICE, *EMPLOYMENT TAX CREDITS EXPIRING DURING THE 106<sup>TH</sup> CONGRESS*, updated Dec. 21, 1999, reprinted in CRS Reports on Welfare-to-Work and Work Opportunity Tax Credits (Doc. 2000-828, Release Date: Jan. 04, 2000), 2000 TNT 3-27 (Jan. 5, 2000) [hereinafter CRS EMPLOYMENT TAX CREDIT REPORT]; JOINT ECONOMIC COMMITTEE, U.S. CONGRESS, *THE WELFARE-TO-WORK TAX CREDIT* 6-9 (Mar. 1997) (responding to the administration's analysis of proposed changes) [hereinafter JOINT ECONOMIC COMM. WWTC REPORT]. See also Anne L. Alstott, *Work v. Freedom: A Liberal Challenge to Employment Subsidies*, 108 YALE L.J. 967, 1036-38 (1999) (discussing the specific changes from prior law and noting some additional problems created by the changes).

18 S. REP. NO. 104-281, at 32, reprinted in 1996 U.S.C.C.A.N. 1474, 1506. See also H.R. CONF. REP. NO. 104-737, at 205-07, reprinted in 1996 U.S.C.C.A.N. 1677, 1697-99 (generally following the Senate amendment).

19 Statement by President William J. Clinton upon Signing H.R. 3448, 32 WEEKLY COMP. PRES. DOC. 1475 (Aug. 26, 1996), reprinted in 1996 U.S.C.C.A.N. 1862, 1863.

20 Robert Pear, *Clinton Will Seek Tax Break to Ease Path Off Welfare*, N.Y. TIMES, Jan. 28, 1997, at A1 (quoting senior advisers to President Clinton for the Administration's view that the new tax credit would be more effective than earlier versions as "just one piece of an overall strategy to make work more attractive than welfare," with other elements including "child care, an increase in the minimum wage, health insurance for people leaving welfare and transportation to help people get to their jobs").

21 E.g. Lawrence F. Katz, *Wage Subsidies for the Disadvantaged* in GENERATING JOBS 21, 23, 46, 48-49 (eds. Richard B. Freeman & Peter Gottschalk, 1998); see also Frederick J. Tannery, *Targeted Jobs Tax Credits and Labor Market Experience*, University of Pittsburgh, available from Employment Policies Institute, Washington, D.C., at <http://www.epionline.org> (1998) (finding positive wage effects from the TJTC for disadvantaged youth and female welfare recipients in a long-term analysis of 17,000 Pennsylvania workers).

22 JOINT ECONOMIC COMMITTEE, U.S. CONGRESS, *THE WELFARE-TO-WORK TAX CREDIT*, Executive Summary (Mar. 1997) (concluding that "it is unlikely that the proposed differences between the Welfare-to-Work Tax Credit and its predecessor will effectively address the shortcomings of the earlier plan" and that "the proposed plan may create other problems and inefficiencies which are common to targeted tax credits of its kind").

23 The former New Jobs Credit, discussed above, was designed as an incremental credit tied to a general increase in the employer's workforce. In contrast, the TJTC, which was a targeted or categorical hiring subsidy, was designed to provide an incentive for employers to hire from certain low-skilled, hard-to-place groups.

24 See George K. Yin, et al., *Improving the Delivery of Benefits to the Working Poor: Proposals to Reform the Earned Income Tax Credit Program*, 11 AM. J. TAX POL'Y 225, 291-93 (1994).



25 S. REP. NO. 104-281, at 32, *reprinted in* 1996 U.S.C.C.A.N. 1474, 1506; H.R. CONF. REP. NO. 104-737, at 205-07, *reprinted in* 1996 U.S.C.C.A.N. 1677, 1697-99 (generally following the Senate amendment).

26 Wages are defined as under the Federal Unemployment Tax Act (FUTA). I.R.C. § 51(c)(1) (referring to § 3306(b)). As with the WtW tax credit, "qualified first-year wages" means wages attributable to services "rendered during the 1-year period beginning with the day the individual begins work for the employer." I.R.C. § 51(b)(2).

27 I.R.C. §§ 51(a), (b), (i)(3). The credit percentage is reduced to 25 percent of those wages for employees who perform at least 120 hours, but less than 400 hours, of service for the employer. I.R.C. § 51(i)(3)(A). No wages are taken into account unless the employee has performed at least 120 hours of service for the employer. I.R.C. § 51(i)(3)(B).

28 No deduction is allowed for the employee's wages to the extent of the amount of the credit I.R.C. § 280C(a). This limitation also applies to the WtW tax credit. I.R.C. § 51A(d)(2). This prevents the combination of the wage deduction and the credit from providing a tax benefit in excess of the amount of wages actually paid, and is similar in effect to making the tax credit taxable. See STANLEY S. SURREY & PAUL R. MCDANIEL, *TAX EXPENDITURES* 41, 111 (1985). For example, for each eligible worker, a corporate employer in the 35% tax bracket would gain a maximum \$2,400 credit and would lose a deduction of \$2400, worth \$840 (35% x \$2,400) to that employer. See I.R.C. § 280C(a).

29 See I.R.C. §§ 51(a) and 38(b)(2).

30 See I.R.C. §§ 38(c), (d); 39.

31 I.R.C. § 51(d)(11)(a) (state employment security agency).

32 I.R.C. § 51(d)(12)(A). If a certificate is later determined to be incorrect due to false information provided by the employee, the agency must revoke the certificate, and wages paid after the employer receives notice of revocation are not qualified wages. I.R.C. § 51(d)(12)(B). If the agency denies a request for certification, it must provide a written explanation of the reasons for denying the request. I.R.C. § 51(d)(12)(C).

33 I.R.C. § 51(i). This limitation also applies to the WtW tax credit. I.R.C. § 51A(d)(1) (cross referencing § 51(i)).

34 I.R.C. § 51(f). This limitation also applies to the WtW tax credit. I.R.C. § 51A(d)(1) (cross referencing § 51(f)).

35 I.R.C. § 51(i)(2) (as amended by Pub. L. No. 106-170, § 505(b), 113 Stat. 1860, by striking "during which he was not a member of a targeted group" after "at any time.>").

36 No credit is available for wages for any period during which the employer receives federally funded payments for on-the-job training for the employee. I.R.C. § 51(c)(2)(A). Wages otherwise eligible for the credit are reduced by the amount of work supplementation payments received by the employer under the Social Security Act with respect to the employee. I.R.C. § 51(c)(2)(B).

37 I.R.C. § 51(c)(3) (wages paid to employees hired to work at a plant or facility of the employer during a period when a strike or lockout involves the employees at the plant or facility are not eligible for the credit if they are paid for services "substantially similar to" those performed by employees "participating in, or affected by," the strike or lockout).

38 I.R.C. § 52 (providing that all members of a controlled group of corporations are treated as a single employer and that the WOTC credit with respect to each member shall be its proportionate share of the wages giving rise to the credit, and providing similar rules for

unincorporated businesses under common control). Similar rules apply to the WtW tax credit. I.R.C. § 51A(d)(1) (crossreferencing I.R.C. § 52).

39 I.R.C. § 52(c) (other than cooperatives described in I.R.C. § 521). See also I.R.C. § 51A(d)(1) (applicable also to WtW tax credit).

40 Like the WOTC, the WtW tax credit is structured as part of the general business credit. See I.R.C. §§ 51A(d)(2) and 38(b)(2).

41 H.R. CONF. REP. NO. 105-148, at 383, *reprinted in* 1997 U.S.C.C.A.N. 678, 777 ("It is also intended to provide certain employee benefits to these individuals to encourage training, health coverage, dependent care and ultimately better job attachment."); see also H.R. CONF. REP. NO. 105-220, at 440-41, *reprinted in* 1997 U.S.C.C.A.N. 1129, 1252-53 (following the House bill); Statement of President William J. Clinton Upon Signing H.R. 2014, 33 WEEKLEY COMP. PRES. DOC. 1192 (Aug. 11, 1997), *reprinted in* 1997 U.S.C.C.A.N. 1620-1, 1620-3 ("I am pleased that H.R. 2014 includes a modified version of my welfare-to-work tax credit proposal, which is designed to generate new job opportunities for long-term welfare recipients.").

42 I.R.C. § 51A(a).

43 I.R.C. § 51A(b)(2), (3).

44 I.R.C. § 51A(b)(1).

45 I.R.C. § 51A(b)(5)(B)(i), (ii) (covering the reasonable cost of coverage for the period, but not more than the applicable premium defined under I.R.C. § 4980B(f)(4)).

46 I.R.C. § 51A(b)(5)(B)(iii) (relating to educational assistance excludable from gross income under I.R.C. § 127).

47 I.R.C. § 51A(b)(5)(B)(iv) (relating to dependent care assistance programs under I.R.C. § 127).

48 I.R.C. § 51A(c)(1) (defined by reference to § 51(d)(11) as a state employment security agency).

49 I.R.C. § 51A(d)(1).

50 I.R.C. § 51A(c)(1)(A).

51 I.R.C. § 51A(c)(1)(B).

52 I.R.C. § 51A(c)(1)(C).

53 I.R.C. § 51A(e) (providing that if a WtW tax credit is allowed to an employer with respect to an individual employee for the taxable year, then the employee cannot be treated as a member of a targeted group for purposes of the WOTC credit for the taxable year).

54 See I.R.C. §§ 51A(b)(5)(A), (C), (c)(1), (2), (d). Like the WOTC, the WtW tax credit is also coordinated with the empowerment zone employment credit. I.R.C. §§ 51A(d)(2), 1396(c)(3) (providing that the same wages cannot be taken into account for multiple credits and that the \$15,000 per calendar year per worker limit of wages to be taken into account for purposes of the empowerment zone employment credit is reduced by the wages taken into account for the calendar year in determining the WtW tax credit or the WOTC credit). For a description of the empowerment zone employment credit, see *supra* note 9.

55 See I.R.C. §§ 51(j), 51A(d)(1) (employer may elect out of having the credit apply for any taxable year). The election may be made (or revoked) at any time before the expiration of the 3-year period beginning on the last date for filing the return for the taxable year (without regard to extensions). *Id.*

56 See IRS Notice 97-54, 1997-2 C.B. 306 (providing examples); see also IRS Notice 99-51, 1999-40 I.R.B. 447 (describing the operation of the credits when an individual is employed by more than one

*Continued on page 12*

employer in the process of moving from welfare to work).

57 Edward A. Zelinsky, *Efficiency and Income Taxes: The Rehabilitation of Tax Incentives*, 64 TEX. L. REV. 973, 1033-35 (1986).

58 Id. at 1034.

59 See, e.g., Katz, *supra* note 21, at 30; see generally 1986 TREASURY EMPLOYMENT SUBSIDIES REPORT, *supra* note 16, at 5 (estimating the total budgetary cost of the two-year NJTC as \$9.7 billion).

60 Katz, *id.* at 32-33.

61 Id. at 29.

62 Daniel S. Hamermesh, *Subsidies for Jobs in the Private Sector*, in CREATING JOBS: PUBLIC EMPLOYMENT PROGRAMS AND WAGE SUBSIDIES 95 (John L. Palmer, ed., 1978).

63 See 1986 TREASURY EMPLOYMENT SUBSIDIES REPORT, *supra* note 16, at 19.

64 See <http://workforcesecurity.doleta.gov/employ/updates.asp> (modified in April 2002). In Virginia, just over two thousand certifications per quarter were issued by the state in fiscal year 2001. In fiscal year 2002, quarterly certifications have declined somewhat over last year. Telephone conversation with Mrs. Jeff Primer, WOTC/Welfare-To-Work Credit Coordinator, Virginia Employment Commission (VEC), Richmond, Virginia (May 16, 2002). See generally <http://www.vec.state.va.us/index.cfm> (employer services, VEC publications and certification forms) (last visited on May 22, 2002).

65 See CRS EMPLOYMENT TAX CREDIT REPORT, *supra* note 17, at ¶¶ 29-32.

66 See U.S. GENERAL ACCOUNTING OFFICE, WORK OPPORTUNITY TAX CREDIT: EMPLOYERS DO NOT APPEAR TO DISMISS EMPLOYEES TO INCREASE TAX CREDITS, GAO-01-329, at 2-3, 8-9 (March 2001) (finding little churning of employees; "certified workers with earnings within plus or minus \$1,000 of the \$6,000 credit maximizing level were no more likely to separate from their employers than other certified workers").

67 Id. at 2, 10.

68 U.S. GENERAL ACCOUNTING OFFICE, BUSINESSES' USE OF EMPOWERMENT ZONE TAX INCENTIVES, GAO/RCED-99-253, at 2, 6-11 (Sept. 30, 1999).

69 Id. at 18.

70 Edith Brashares, *Empowerment Zone Tax Incentive Use: What the 1996 Data Indicate*, 20 STAT. INCOME BULL. 236, 246 (Summer 2000).

71 Id. at 244, 246.

72 Id. at 237 (also discussing the effects of the credit limitations and general business credit carryforward rules).

73 Spending for employment security administration of the two programs has been \$20 million per fiscal year. CRS EMPLOYMENT TAX CREDIT REPORT, *supra* note 17, at ¶33.

## Practitioner's Perspective

# STRATEGIES FOR REACHING THE WELFARE-TO-WORK POPULATION

by Vaughn E. James

In the book of Matthew, the Bible tells an interesting story of a king who hosted a marriage feast for his son.<sup>1</sup> The king invited several guests to the feast. Alas, when the great day arrived, the guests refused to come! One by one, they made excuses, choosing to engage in other activities rather than attend the reception. One went off to his farm, another to his place of business; others seized the servants whom the monarch had sent to escort them to the feast, treated them shamefully, and killed them. In the end, the king had a second group of servants fan out throughout the city inviting everyone they met to the wedding reception. By the

time the feast started, the hall was filled with all sorts of people - in today's parlance, rich and poor, black and white, Asians and Latinos, men and women.

**C**ontrary to reports that workfare is bringing tremendous relief, new work ethics and pride to America's poor and underprivileged, the truth is that several former and current welfare recipients have not been benefiting from this bountiful harvest.

This Biblical parable of the marriage feast contains some interesting parallels to the now almost seven-year-old story of the welfare-to-work program. When, in 1996, Congress and President Clinton abolished welfare as it was and initiated the welfare-to-work program,<sup>2</sup> they collectively acted like the king in the Biblical parable. They were providing something they believed to be of great benefit to their constituents. Like the Biblical

king, they expected their constituents to readily partake of this great feast. Confident that they had brought significant, positive change to this country, both Congress and President Clinton lauded the virtues of the welfare-to-workfare program.<sup>3</sup> In fact, President Clinton himself loudly touted welfare reform as one of the major achievements of his administration.<sup>4</sup>

To get the program going in the right direction, the government united with business to form the Welfare-